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No. 06-653

IN THE

Supreme Court of the United States

CHARLES W. TURNBAUGH, in his official capacity as Commissioner of Financial Regulation, Maryland Department of Labor, Licensing and Regulation,

Petitioner,

v.

NATIONAL CITY BANK OF INDIANA, *ET AL.*,

Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Fourth Circuit

RESPONSE TO PETITION FOR A WRIT OF CERTIORARI

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QUESTION PRESENTED

Whether mortgage lending activities conducted through a national bank operating subsidiary are subject to the exclusive supervision and regulation of the Office of the Comptroller of the Currency, just as they are when conducted directly by the parent national bank.

PARTIES TO THE PROCEEDING AND RULE 29.6 STATEMENT

The petitioner is Charles W. Turnbaugh, Commissioner of Financial Regulation, Maryland Department of Labor, Licensing and Regulation. Petitioner was the defendant in the district court and the appellant in the court of appeals. The respondents are National City Bank of Indiana and two of its operating subsidiaries, National City Mortgage Co. and First Franklin Financial Corporation. The respondents were plaintiffs in the district court and appellees in the court of appeals. During the course of this litigation, Respondent First Franklin Financial Corporation changed its name to First Franklin Financial Companies, Inc., and Respondent National City Mortgage Co. changed its name to National City Mortgage, Inc. For convenience, the parties have continued to refer to the Respondents by their prior names. On December 30, 2006, Merrill Lynch Bank & Trust Co., FSB, purchased assets of the former First Franklin Financial Corporation.

National City Mortgage Co. and First Franklin Financial Corporation are wholly-owned subsidiaries of National City Bank of Indiana, which in turn is a wholly-owned subsidiary of National City Corporation, a publicly-traded financial services holding company.

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The opinion of the court of appeals (Pet. App. 1-13) is reporte 463 F.3d 325. The opinion of the district court (Pet. A 4-41) is reported at 367 F. Supp. 2d 805.

JURISDICTION

The judgment of the court of appeals was entered on August 10, 2006. The petition for a writ of certiorari was filed on November 7, 2006. The jurisdiction of this Court rests on 28 U.S.C. § 1254(1).

STATEMENT OF THE CASE

1. Respondent National City Bank of Indiana is a federally-chartered national bank. Pet. App. 16. When this litigation commenced, two of its wholly-owned operating subsidiaries – National City Mortgage Co. and First Franklin Financial Corporation – made mortgage loans to customers in several states, including Maryland. *Id.* National City Mortgage Co. is an Ohio corporation that has its principal place of business in Ohio; First Franklin is a Delaware corporation that has its principal place of business in California. *Id.*[1]

In June 2004, a financial examiner in the office of Maryland's Department of Labor, Licensing and

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[1] As of January 1, 2005, Respondents restructured their mortgage lending business so that mortgage loans are now made directly by National City Bank of Indiana rather than through its operating subsidiaries. Pet. App. 18 n.4. In addition, on December 31, 2006, the bank sold the assets of the former First Franklin Financial Corporation to Merrill Lynch Bank & Trust Co., FSB.

Regulation sent a letter to First Franklin stating that a provision in a mortgage agreement between First Franklin and a borrower in Maryland appeared to violate a Maryland law restricting the fees that a mortgage lender may charge a borrower in the event the borrower elects to prepay an Adjustable Rate Mortgage (ARM). Pet. App. 18. The letter asked First Franklin to submit "a list of all Maryland residents charged a prepayment penalty after July 1, 2003." *Id.* In replying to the letter, Respondents noted that national banks and their operating subsidiaries are authorized by federal law to charge a fee for prepayment of ARMs. *Id.*[2] In August 2004, after Petitioner's office forwarded a second consumer complaint to First Franklin raising the same issue, Respondents filed this action to determine their obligations under federal and state law. *Id.*

2. The parties stipulated to the entry of a preliminary injunction enjoining Petitioner from enforcing the prepayment restriction or otherwise exercising visitorial powers over Respondents. Pet. App. 15. Thereafter, the district court entered summary judgment for the Respondents and permanently enjoined Petitioner from enforcing the challenged provisions of state law against Respondents, and from exercising visitorial authority over national banks. *Id.* at 14-41.

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[2] The Comptroller of the Currency has authorized national banks and their operating subsidiaries to charge prepayment fees, because such fees "'minimize the risk of prepayment during the period prior to the first rate change notification date and therefore [mortgage lenders] will be encouraged to make ARMs with long initial grace periods or subject to less frequent rate adjustments.'" Pet. App. 37, quoting 46 Fed. Reg. 18,939 (Mar. 27, 1981).

The court observed that "[t]here is no dispute that the state law, and [Petitioner's] attempt to enforce it against national bank operating subsidiaries . . . , are in conflict with the federal regulations that permit prepayment charges and declare that only the OCC may exercise visitorial powers over the [operating subsidiaries]." Pet. App. 25. The district court analyzed the case under "two related but analytically distinct frameworks," *id.*, and concluded that both lines of analysis lead to the conclusion that the OCC's regulations are valid and the Maryland laws at issue are preempted.

Applying the framework of *Fidelity Federal Savings and Loan Association v. de la Cuesta*, 458 U.S. 141 (1982), the court asked (i) "whether the OCC intended to pre-empt conflicting state law" and (ii) "if so, whether that action was within the scope of the authority delegated to the OCC by Congress." Pet. App. 27. Under this framework, the court noted, there is no requirement that Congress must expressly delegate authority to preempt state law to the OCC. Pet. App. 30-31 (citations omitted). Moreover, in the Gramm-Leach-Bliley Act, Pub. L. No. 106-102, 113 Stat. 1338 (1999), "Congress implicitly recognized and affirmed the OCC's approach to regulating operating subsidiaries of national banks." Pet. App. 32, quoting 12 U.S.C. § 24a(g)(3)(A). The court found additional support for its conclusion in decisions of this Court that "'have treated the activities of an operating subsidiary as being equivalent to the activities of the national bank.'" Pet. App. 31-32, quoting *Wells Fargo Bank, N.A. v. Boutris*, 265 F. Supp. 2d 1162, 1168 (E.D. Cal. 2003), citing, *e.g.*, *NationsBank of N.C., N.A. v. Variable Annuity Life Ins. Co.*, 513 U.S. 251, 254 (1995).

The court reached the same result under the framework of *Chevron U.S.A. Inc. v. Natural Resources Defense Council*, 467 U.S. 837 (1984). Pet. App. 33. The court held that the OCC's regulations, including in

particular 12 C.F.R. § 7.4006, are a reasonable interpretation of "a combination of pre-existing statutes – section 484, section 24(Seventh), and section 371." Pet. App. 34, citing *Wachovia Bank, N.A. v. Burke*, 319 F. Supp. 2d 275, 282 (D. Conn. 2004). The court agreed that

> "[s]tate regulation of national bank wholly-owned subsidiaries could reasonably be conceived to have the same obstructive effect on national bank operations as they would if they were directed at the bank itself. If the state could regulate national bank subsidiaries . . . it could, merely because of the differences in corporate form, enforce regulations on activities which it could not regulate were they conducted through the bank itself. If, because of such regulation, the bank declined to utilize its ability to conduct its activity through the subsidiary, it would thus be hindered in its exercise of a recognized section 24 (Seventh) 'incidental' power."

Pet. App. 35, quoting *Wachovia*, 319 F. Supp. 2d at 286-87.

3. The court of appeals unanimously affirmed. Pet. App. 1-13. The court began by "summariz[ing] the relevant federal statutory and regulatory framework." Pet. App. 5. "Congress enacted the NBA in 1864 to facilitate . . . a national banking system." Pet. App. 5, quoting *Marquette Nat'l Bank of Minneapolis v. First of Omaha Serv. Corp.*, 439 U.S. 299, 314-15 (1978) (internal quotation and citation omitted). "The OCC has the 'primary responsibility for surveillance of the "business of banking" authorized by [the NBA].'" Pet. App. 6, quoting *NationsBank*, 513 U.S. at 256.

The court's analysis focused on three federal statutory provisions and related OCC regulations. *First*, national banks have "general authority to 'exercise all such incidental powers as shall be necessary to carry on the business of banking.'" Pet. App. 6, quoting 12 U.S.C. § 24 Seventh. Pursuant to this authority, "the OCC allows national banks to conduct 'business of banking activities' through operating subsidiaries." Pet App. 6, citing 12 C.F.R. § 5.34(e)(1).

Second, "national banks may engage in residential lending as regulated by the OCC." Pet. App. 6, citing 12 U.S.C. § 371(a). The OCC's regulations implementing this provision provide that "national banks and subsidiaries may deal in ARM loans 'without regard to any State law limitations on those activities,'" and that "'[a] national bank offering or purchasing ARM loans may impose fees for prepayments notwithstanding any State law limitations to the contrary.'" Pet. App. 6, quoting 12 C.F.R. §§ 34.21(a) & 34.23.

Third, "[n]o national bank shall be subject to any visitorial powers except as authorized by federal law . . . ." Pet. App. 6, quoting 12 U.S.C. § 484(a). An OCC regulation provides that "[u]nless otherwise provided by Federal law or OCC regulation, State laws apply to national bank operating subsidiaries to the same extent that those laws apply to the parent national bank." Pet. App. 7, quoting 12 C.F.R. § 7.4006.

The court of appeals next applied preemption principles to the state laws at issue. The court rejected Petitioner's contention that a "presumption against preemption" applies in this case, noting that "'an "assumption" of nonpre-emption is not triggered when [a] State regulates in an area where there has been a history of significant federal presence." Pet. App. 8, quoting *United States v. Locke*, 529 U.S. 89, 108 (2000). The court

observed that "[t]he regulation of federally chartered banks is indisputably such an area." Pet. App. 8 (citations omitted). Moreover, "'grants of both enumerated and incidental powers to national banks' are 'not normally limited by, but rather *ordinarily pre-empt*[ ], contrary state law.'" Pet. App. 8, quoting *Barnett Bank of Marion County, N.A. v. Nelson*, 517 U.S. 25, 32 (1996) (emphasis added by court of appeals). Because the OCC's regulations "define the scope of the national banks' authority to conduct business through operating subsidiaries," and "undoubtedly these issues involve the 'incidental powers' of national banks," the court of appeals concluded there is no presumption against preemption in the circumstances of this case. Pet. App. 8-9.

Because "[t]he parties agree that the Maryland banking laws conflict with the OCC regulations," it follows that the Maryland laws at issue are preempted "unless the OCC 'exceeded its authority or acted arbitrarily.'" Pet. App. 9, quoting *de la Cuesta*, 458 U.S. at 153-54. In concluding that the OCC did not exceed its authority or act arbitrarily, the court of appeals applied the familiar *Chevron* framework. The court held that "Congress has not spoken directly about whether the OCC has authority to regulate operating subsidiaries." Pet. App. 10. The court concluded that "[t]he absence of any reference to operating subsidiaries in the Bank Act does not unambiguously provide that national banks may not create and perform banking functions through such entities." Pet. App. 10, quoting *Wells Fargo Bank N.A. v. Boutris*, 419 F.3d 949, 959 n.12 (9th Cir. 2005).

The court further held that "the OCC's regulations are based on a permissible construction of the NBA." Pet. App. 10. The "'"business of banking"' is not limited to the enumerated powers in § 24 Seventh and . . . the Comptroller therefore has discretion to authorize activities beyond those specifically enumerated.'" Pet.

App. 11, quoting *NationsBank*, 513 U.S. at 258 n.2. Here, "the OCC's regulation of operating subsidiaries does not exceed the limitations contemplated in *NationsBank*." Pet. App. 11. "'Allowing national banks to create, control, and delegate banking functions to operating subsidiaries provides some assistance to banks in performing their authorized activities.'" *Id.*, quoting *Wells Fargo*, 419 F.3d at 960. The court noted that the OCC limits the activities national banks can conduct through operating subsidiaries to activities that can be conducted directly by the bank. Pet. App. 11-12, citing 12 C.F.R. § 5.34(e)(3).

Finally, the court held that 12 C.F.R. § 7.4006, which provides that state laws generally apply to operating subsidiaries to the same extent that they apply to the parent national bank, "is reasonable and within the OCC's delegated authority." Pet. App. 12. The court of appeals found the OCC's reasoning "compelling": "'When national banks are unable to operate under uniform, consistent, and predictable standards, their business suffers, which negatively affects their safety and soundness.'" Pet. App. 12, quoting 69 Fed. Reg. 1904 (Jan. 13, 2004). The court of appeals concluded: "We join the Second, Sixth, and Ninth Circuits in finding the OCC did not exceed its delegated authority." Pet. App. 13.

ARGUMENT

There is no split in the circuits on the question presented by the petition. Every court – indeed, every single judge – that has considered the OCC's regulations has determined that they are valid. *See Wachovia Bank, N.A. v. Watters*, 431 F.3d 556 (6th Cir. 2005), affirming 334 F. Supp. 2d 957 (W.D. Mich. 2004); *Wells Fargo Bank, N.A. v. Boutris*, 419 F.3d 949 (9th Cir. 2005), affirming 265 F. Supp. 2d 1162 (E.D. Cal. 2003); *Wachovia Bank, N.A. v. Burke*, 414 F.3d 305 (2d Cir. 2005), affirming 319 F. Supp. 2d 275 (D. Conn. 2004). In June 2006, however,

this Court granted the petition for a writ of certiorari in *Watters v. Wachovia Bank, N.A.*, No. 05-1342. The Court heard oral argument in *Watters* on November 29, 2007. Petitioner asks the Court to hold its petition in this case pending its decision in *Watters*.

Watters differs from this case in at least three respects. *First*, the petition in *Watters* presents two questions, rather than the single question presented in this case. The questions presented in *Watters*, as framed by the petitioner in that case, are: (1) "Is the interpretation of the Comptroller of the Currency that 12 CFR 7.4006 preempts Michigan's laws regulating mortgage lending as applied to State-chartered nonbank operating subsidiaries, entitled to judicial deference under *Chevron USA, Inc. v. Natural Resources Defense Council*?" and (2) "Does 12 CFR 7.4006, by equating a State-chartered nonbank operating subsidiary with a national bank for purposes of federal preemption of State regulation, intrude on State sovereignty in violation of the Tenth Amendment to the United States Constitution?" Pet. Br. in No. 05-1342, at i. The Petitioner in this case has not raised a Tenth Amendment issue, either in his petition for certiorari or in the courts below. Accordingly, the second question presented in *Watters* is not presented in this case, and provides no basis for holding the petition.

Second, this case differs from *Watters* in that Petitioner not only seeks to subject national bank operating subsidiaries to state licensing, examination, and enforcement provisions, but also to a substantive limitation on ARM prepayment fees. This limitation on mortgage fees clearly is preempted when ARM loans are made directly by national banks. *See* 12 U.S.C. § 371(a); 12 C.F.R. Part 34. Petitioner nevertheless contends that states are free to impose different substantive terms and conditions when a national bank makes a mortgage loan

through an operating subsidiary rather than when the national bank does so directly.

Third, while this litigation was pending, Respondents restructured their mortgage lending business, so that mortgage loans are now made directly by the parent national bank rather than through operating subsidiaries. At year-end 2004, Respondent First Franklin Financial Corporation was renamed First Franklin Financial Companies, Inc., and some of its assets were contributed to a new corporation (also named First Franklin Financial Corporation). Respondent National City Mortgage Co. was renamed National City Mortgage, Inc. In addition, on December 30, 2006, Merrill Lynch Bank & Trust Co., FSB purchased from National City Bank 100 percent of the issued and outstanding stock of the new First Franklin Financial Corporation. Merrill Lynch Bank & Trust Co., FSB is a federal savings bank rather than a national bank. Respondent First Franklin Financial Companies, Inc. remains in existence as a subsidiary of National City Bank, but the bank continues to make mortgage loans directly rather than through an operating subsidiary. These developments have complicated this case, making it an undesirable vehicle for resolving the question presented. Moreover, Respondents' decision to cease making mortgage loans through operating subsidiaries, and its sale of the assets of the former First Franklin Financial Corporation to a federal savings bank, have significantly narrowed the scope of the dispute between Petitioner and Respondents.

Despite these differences, there is a substantial overlap between the question presented by the petition in this case and the first question presented in *Watters*. Accordingly, the Court may wish to hold the petition in this case pending its decision in *Watters*.

CONCLUSION

The petition should be denied. Alternatively, the Court may wish to hold the petition pending its decision in *Watters v. Wachovia Bank, N.A.*, No. 05-1342, and then dispose of the petition as appropriate in the light of the decision in that case.

Respectfully submitted,

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